



GUARANTEED ENERGY SAVINGS PERFORMANCE CONTRACTING

Opportunities for State and Local Governments In Kentucky

Energy Savings Performance Contracting (ESPC) is a viable way for governments to save energy and money by securing private sector expertise and financing of energy-efficiency improvement projects through the savings these projects are guaranteed to produce. Performance Contracting allows institutions to

- make building improvements when capital dollars are not available;
- update aging equipment with newer, more efficient products;
- reduce energy costs without sacrificing service;
- reduce maintenance costs.

The Kentucky General Assembly has enacted three bills, HB-639 (1998), HB-264 (1996), and SB-157 (1996), which establish the basis for energy efficiency in state and local government

buildings. These bills authorize guaranteed energy savings performance contracting, which can include private sector financing to fund these projects. The purpose of this fact sheet is to communicate key legislative requirements for Energy Savings Performance Contracts (ESPCs) in Kentucky, and to note the steps needed in making ESPCs work to the advantage of all affected parties. This fact sheet does not convey fully every detail of the statutes and policies that may apply.

***Guaranteed energy savings performance contract** means a contract for evaluating and recommending energy conservation measures and for implementing one or more of those measures. The contract shall provide that all payments, except obligations on termination of the contract before its expiration, are to be made over time and the savings are guaranteed to the extent necessary to make payments for the cost of the design, installation, and maintenance of energy conservation measures.*



I. Background

A. History of Legislation Enacted

- The legislation is permissive in that ESPCs are not mandated, but when they are used, the provisions of the legislation must be followed. The legislation is intended to provide a mechanism through ESPCs to assist government agencies in making buildings more energy-efficient.
- The 1996 legislation (HB-264) provided for the use of ESPCs as a private sector financing mechanism. ESPCs require that qualified providers (Energy Service Companies, ESCOs) guarantee that the savings realized will pay for energy improvements.
- HB-639, enacted in 1998, stipulates requirements for local governments that had been previously specified by regulations under the 1996 legislation and expands on these regulations.

B. 1996 Legislation

HB-264 (KRS 56.770 – 56.784)

- Authorizes the energy efficiency program for state and local government buildings.

- Authorizes the use of guaranteed energy savings performance contracts by state government.

SB-157 (KRS 45A.345 - 45A.460)

- Authorizes the use of guaranteed energy savings performance contracts by units of local government.
- Requires regulations to be promulgated by the Department of Education for school districts and the Department for Local Government for cities, counties, and other units of local government. The regulations specify requirements that must be met to use ESPCs. (702 KAR 4:150 for schools and 109 KAR 7:020 for local government).

Note: HB-639 modifies by statute several aspects of the regulations promulgated under the 1996 statutes.

HB-655 (KRS 58.600 – 58.615)

- Authorizes energy conservation revenue bonds for units of local governments.

Note: HB-639 restricts the use of these bonds to ESPCs.

C. 1998 Legislation

HB-639 (See Table 1, *Relevant State Statutes*)

- Affects both state and local governments and ESCOs (private sector vendors) in the use of ESPCs.
- Specifies, by statute, requirements for local governments in the use of ESPCs. These requirements do not apply to state government, but do provide guidelines that could be adopted as policy for state government.
- Amends and expands 1996 statutes as noted below and in sections II, III, and IV.
 - Establishes procedures and requirements for local government and ESCOs.

Note: Policies affecting state government (except the University of Louisville, University of Kentucky, and Murray State University) will be issued by the Department for Facilities Management, Finance and Administration Cabinet.

- Provides a more specific definition of a “qualified provider” and further details evaluation criteria, including construction management, technical capability, and financial condition.
- Expands the use of several capital funds for ESPCs in state and local governments.



II. Impact of the Legislation on State Government

- Authorizes a program for achieving energy cost savings in state government buildings through ESPCs.
- Exempts state agencies from the model procurement code requirement that each building modification be procured by sealed bid. Competitive bidding is accomplished instead in the vendor selection process. This allows turnkey projects submitted by ESCOs to be considered.
- Allows the Finance and Administration Cabinet to recoup from energy savings the administrative expenses in processing ESPCs. Allows remaining dollar savings to be deposited in the state agency’s account as an incentive for taking action to save energy costs.
- Allows an exception for state agencies to initiate energy-saving projects not included in the agency-enacted budget if projects have a five-year or less simple payback period.

Note: Projects that are \$400,000 or less can be implemented under older statutes.

- Anticipates that the Department for Facilities Management will issue guidelines/regulations for executing ESPCs. Guidelines may include:
 - Establishment of the Department for Facilities Management as the central agency for negotiating ESPCs for most state agencies.
 - A request for qualifications/request for proposal (RFQ/RFP) process for implementing ESPCs.
 - A requirement that financing of projects be included by ESCOs in the ESPC.
 - A process for state agencies with responsibilities for building operations to initiate ESPCs.
 - A process that allows state-supported universities to negotiate ESPCs costing \$400,000 or less independently of the Department for Facilities Management if written permission is granted (University of Kentucky and University of Louisville do not need written permission).
 - Other requirements specified by statutes for local governments (*see section III*).



III. Impact of the Legislation on Local Governments

Entities affected include city, charter county, urban county, school districts, special districts, or agency funded by a combination of these agencies under KRS Chapter 79. The legislation

- Authorizes a program for achieving energy cost savings in local government buildings through ESPCs.

A. Statutory requirements/procedures for ESPC:

- Requires **school districts** to adhere to the approval process (policies/regulations) for ESPCs established by the Department of Education.

Note: Chief state school officer must approve or disapprove ESPCs for local school districts (see “Guidelines,” on page 3).
- Requires **local governments** (except school districts) to adhere to the approval process (policies/regulations) established by the Department for Local Government.

- Requires an RFP or an optional RFQ/RFP process.
 - The final contract negotiated must be within 15 percent of the ESCO’s preliminary proposal estimate; if negotiations cannot reconcile the difference then the local public agency may select an alternate provider.
 - The RFP process satisfies the requirements in KRS 162.070 for low bid and shall not be subject to an award determination based on the lowest competitive bid or a separate bidding process for each energy conservation measure (ECM) listed in the proposal.
 - Local governments may, as a component of the request for proposals, solicit and negotiate additional maintenance services for the proposed energy conservation measures.

- Requires a local public agency to include a project overview stating goals and objectives specific to facility needs in its RFQ or RFP. If the RFQ/RFP approach is used, the local public agency must solicit qualification statements from multiple potential qualified providers. At least two (2) providers are to be selected and each provider then is subject to the RFP requirements (See Section IV).
- Exempts ESPCs from current and future debt limitations except that **capital cost avoidance** shall be limited to current and future debt limitations.
- Stipulates and modifies by statute many of the requirements previously specified by regulations promulgated by the Department of Education and the Department for Local Government.

B. Financing Options for ESPCs

- Permits use of several capital funds for ESPCs by **school districts** as follows:
 - General fund
 - Capital outlay allotment
 - State and local funds from Facilities Support Program
 - The levy equivalent tax rate of five cents (\$0.05) and equalization funds for energy conservation measures (other requirements for levying this tax rate must be met).
- Permits a local public agency to finance the installation of energy conservation measures (ECMs) through a lease-purchase agreement, bonds, or whatever brings the most economical value to the local public agency subject to compliance with all other laws regarding approval of plans for additions, alterations, or renovation of buildings.
- Requires that when energy conservation revenue bonds are used, the total cost of ECMs must not exceed the cost of the energy savings plus the operational cost plus the capital cost avoidance.
 - Restricts the use of energy conservation revenue bonds to ESPCs.
 - Requires the term of energy conservation revenue bonds to run conterminous with the term of the ESPC.
- Authorizes the use of **capital cost avoidance** by a local public agency with certain restrictions.

Chief State School Officer Guidelines for Approval/Disapproval of ESPC

- ā The project design's compliance with technical, health, and safety standards as required by administrative regulation;
- ā The availability of general funds, capital outlay allotments under Section 9 of this Act or local and state funds from the Facilities Support Program of Kentucky as provided by Section 10 of this Act, for projects that will use capital cost avoidance;
- ā The appropriate use of capital outlay allotments under Section 9 of this Act, local and state funds from the Facilities Support Program of Kentucky as provided by Section 10 of this Act, for projects using capital cost avoidance, based on the project's compliance with the district's approved facility plan;
- ā The funding capability of the school district; and
- ā The financing mechanism and proper financing documentation.

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Local Government Requirements for RFP

The Request for Proposal shall include

- ā The name and address of the governmental unit;
- ā The name, address, title, and phone number of a contact person;
- ā Notice indicating that the local public agency is requesting qualified providers to propose energy conservation measures through a guaranteed energy savings contract;
- ā The date, time, and place where proposals must be received;
- ā Any other stipulations and clarifications the local public agency may require; and
- ā An overview prepared by the local public agency stating goals/objectives specific to facility needs to be considered by the qualified providers who are responding to the request. Detailed scope of construction is not required.

Evaluation criteria for assessing proposals

- ā Construction management capabilities;
- ā Technical approach to facilities included;
- ā Financial attributes, as defined by total cost of contract and guaranteed savings and provider's financial strength demonstrating ability to fulfill the guarantee term; and
- ā Provider's capability, personnel, track record, and demonstrated ability to accomplish the contract.

"Capital cost avoidance" means money expended by a local public agency to pay for an energy conservation measure identified as a permanent equipment replacement and whose cost has been discounted by any additional energy and operation savings generated from other energy conservation measures identified in the guaranteed energy savings contract; except that for school districts capital cost avoidance shall also mean moneys expended by the district from one or more of the following sources:

- General fund;
- Capital outlay allotment under Section 9 of this Act; and
- State and local funds from the Facilities Support Program of Kentucky under Section 10 of this Act.

IV. Impact of the Legislation on Energy Service Companies

Energy Service Companies (ESCOs) are “qualified providers” or vendors that negotiate and provide services under ESPCs. ESCOs are required to provide local public agencies:

- The following information regarding a proposed ESPC:
 - Project design and specifications;
 - Construction management;
 - Construction;
 - Commissioning;
 - Ongoing services as required;
 - Measurement and verification of savings for guaranteed energy savings contracts; and
 - Annual reconciliation statements (see next column).
- The following in response to an RFP:
 - A detailed list of the proposed energy conservation measures and the guaranteed savings which shall be supported with calculations. Any guaranteed energy and operational savings shall be determined by using one of the measurement and verification methodologies listed in the U.S. Department of Energy’s “Measurement and Verification Guideline for Federal Energy Projects” or in the “North American Energy Measurement and Verification Protocol.” If due to existing data limitations or the nonconformance of specific project characteristics, none of the methods listed in either of these documents is sufficient for measuring guaranteed savings, the qualified provider shall develop an alternate method that is compatible with one of the two.
 - The estimated cost of the proposed energy conservation measures including engineering, construction, commissioning, measurement and verification, annual reconciliation statements, and required ongoing services; and
- The proposed method and cost of financing.
- **An annual reconciliation statement** with the following stipulations:
 - The statement shall disclose any shortfalls or surplus between guaranteed energy and operational savings specified in the guaranteed energy savings contract and actual energy and operational savings incurred during a given guarantee year. The guarantee year shall consist of a twelve-month term commencing from the time that the energy conservation measures became fully operational.
 - The qualified provider shall pay the local public agency any shortfall in the guaranteed energy and operational savings within thirty days after the total year savings have been determined.
 - If there is a surplus in the actual guaranteed energy and operational savings in a given year, that surplus savings may be carried forward and applied against any possible savings shortfall in the following guarantee year, except that the surplus carried forward is limited to a period not to exceed one year.
 - If the qualified provider pays the local public agency for a shortfall in energy or operational savings incurred during a given guarantee year and there is a surplus in energy or operational savings in future guarantee years, the qualified provider shall bill the local public agency for an amount not to exceed the amount of the shortfall in the given guarantee year.

15% Provision for ESCO’s Final Estimate

The value for total cost of the contract minus the calculated savings from the energy conservation measures listed in the qualified provider’s proposal, shall be within fifteen percent of the value for the total cost of the contract minus the calculated savings after the final contract has been negotiated. If the difference between the proposed and the final contract is not within fifteen percent and the local public agency and the qualified provider are unable to renegotiate the final contract to reconcile the difference between the proposed and final contract values, then the local public agency may: (a) stop negotiations with the current qualified provider; and (b) select an alternate provider. The local public agency may, as a component of the request for proposal, solicit and negotiate additional maintenance services for the affected proposed energy conservation measures.

House Bill No. 639

V. State Government Agencies: Roles & Responsibilities

A. State Government Buildings

Department for Facilities Management, Finance and Administration Cabinet

- Establish guidelines (regulations/procedures) for initiating and negotiating ESPCs for state government buildings that will include requirements for:
 - Financing the project as part of the ESCO turnkey package.
 - Selecting vendors through a RFQ/RFP process (similar to statutory requirements for local government--see section III).
 - Negotiating ESPCs with ESCOs for state projects.
 - Establishing other procedures that likely will be similar to the statutory requirements for local governments (see section III).

See the diagram on page 6, Process for Implementing a Successful ESPC.

Kentucky Division of Energy

- Promote ESPCs – workshops, training, etc.
- Provide technical assistance to state and local governments, including help in negotiating ESPCs.

Other State Agencies

Other state agencies are those with direct building management responsibilities, including state-supported universities except for the University of Kentucky, the University of Louisville, and Murray State University. These three universities can initiate and negotiate ESPCs without the Department for Facilities Management's approval.

- Initiate ESPCs for consideration by Department for Facilities Management. Universities with a project costing \$400,000 or less may initiate and negotiate an ESPC with prior written permission from the Department for Facilities Management.

B. Local Government Buildings

Department of Education, Division of Facilities Management

- Implement approval process for initiated projects by **school districts**.

Department for Local Government

- Implement approval process for initiated projects by units of **local government** other than school districts.

Agency Walk-Through Energy Audits

As part of the Energy Efficiency Program in Government Buildings, the Department for Facilities Management has asked the Kentucky Division of Energy to be the lead agency in state government for implementing low-cost/no-cost measures in government buildings. Through this program, maintenance and operational personnel will be trained to conduct walk-through energy audits which will identify both low-cost/no-cost measures and higher cost building improvements that may be implemented. This work can lead to a request for an ESPC project by a state agency.

Decision Making Process for Energy Savings Performance Contracting

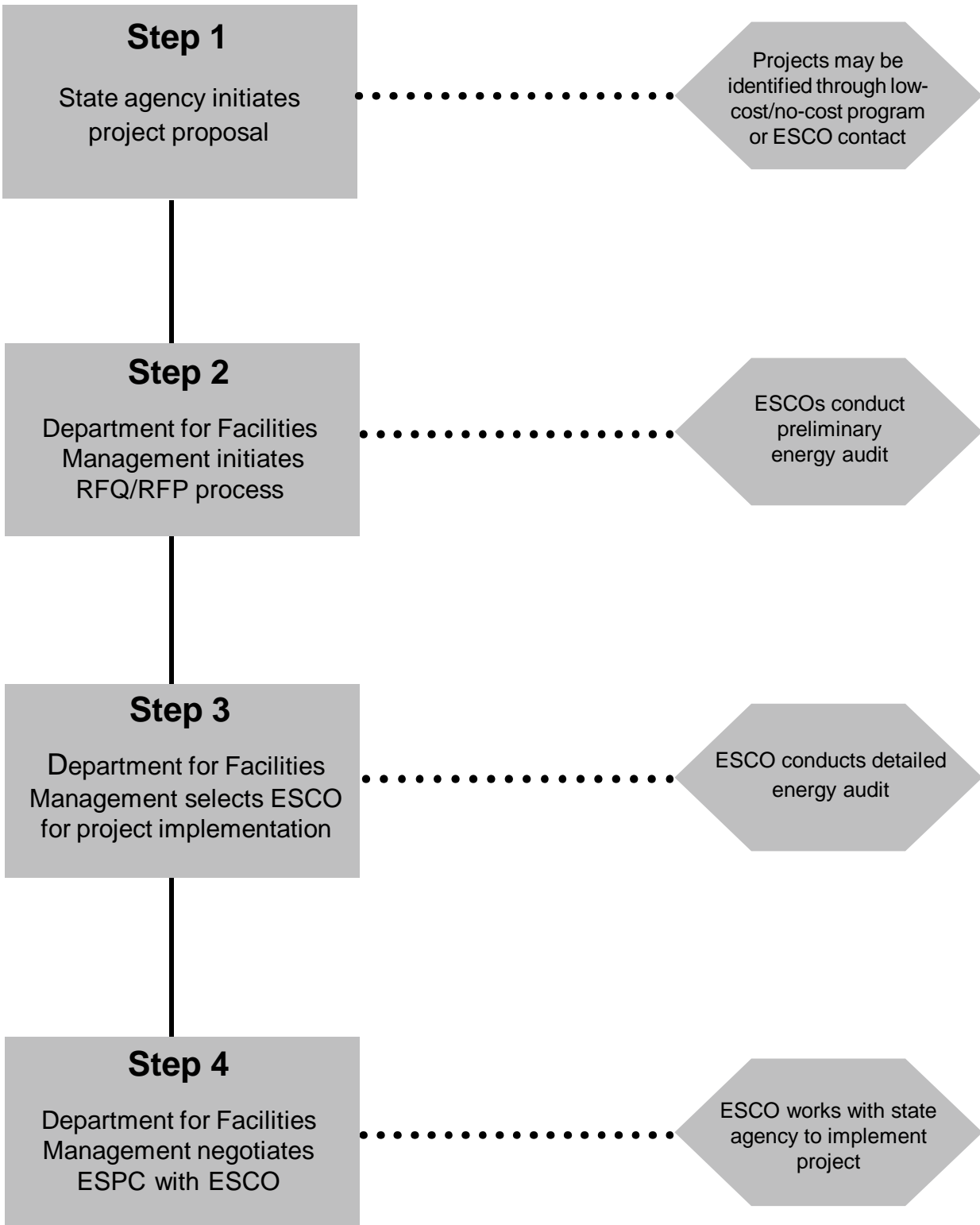


Table 1.— Relevant State Statutes

State Government

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|------------------------|--|
| <i>KRS 45.760 (14)</i> | <ul style="list-style-type: none">• Allows the implementation of energy conservation projects with an aggregate simple payback period of five years or less that have not been included in an agency-enacted budget. |
| <i>KRS 56.770</i> | <ul style="list-style-type: none">• Provides definitions for KRS 56.770 – 56.784. |
| <i>KRS 56.774(2)</i> | <ul style="list-style-type: none">• Allows competitive bidding requirements to be accomplished through the RFP process.• Requires energy analyses to be performed by qualified engineers, architects, or others trained in energy efficiency. |
| <i>KRS 56.774(5)</i> | <ul style="list-style-type: none">• Allows the use of guaranteed ESPCs in state-owned buildings that have reasonable economic benefit to the commonwealth.• Allows Finance and Administration Cabinet to be reimbursed for its expenses from energy cost savings after the cost of the project is recovered, with remaining funds going to the affected state agency account. |
| <i>KRS 56.784</i> | <ul style="list-style-type: none">• Gives authority for Finance and Administration Cabinet to issue regulations. |

Local Government

- | | |
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| <i>KRS 45A.345</i> | <ul style="list-style-type: none">• Provides definitions for KRS 45A.343 – 45.460. |
| <i>KRS 45A.352</i> | <ul style="list-style-type: none">• Allows a local public agency to use guaranteed energy savings contracts, specifies information requirements, project evaluation criteria, and respondent (ESCOs) requirements. |
| <i>KRS 45A.353</i> | <ul style="list-style-type: none">• Provides guidelines for chief state school officer to evaluate projects.• Specifies financing options and the use of capital cost avoidance.• Provides exemption from current and future debt limitations except that capital cost avoidance shall not be exempt from current and future debt limitations. |
| <i>KRS 58.600</i> | <ul style="list-style-type: none">• Provides definitions for KRS 58.600 to 58.610. |
| <i>KRS 58.605</i> | <ul style="list-style-type: none">• Relates to energy conservation revenue bonds.• Allows a local public agency to issue energy conservation revenue bonds to pay for energy conservation measures under a guaranteed energy savings contract.• Provides issuing provisions and sale procedures for energy conservation revenue bonds |
| <i>KRS 157.420(5)</i> | <ul style="list-style-type: none">• Allows the use of capital outlay funds for energy conservation measures with restrictions. |
| <i>KRS 157.440(1)(c)</i> | <ul style="list-style-type: none">• Allows school districts to contribute the levy equivalent tax rate of five cents (\$0.05) and equalization funds for energy conservation measures under specified guidelines. |

ESCOs

- | | |
|-----------------------------|---|
| <i>KRS 45A.345(28)</i> | <ul style="list-style-type: none">• Defines qualified provider (ESCO) responsibilities. |
| <i>KRS 45A.352(2)(3)(8)</i> | <ul style="list-style-type: none">• Stipulates requirements for proposals. |

Resources - Key Agencies in State Government

Information About ESPC

Department for Facilities Management

(Finance and Administration Cabinet)
Room 76, Capitol Annex
Frankfort, KY 40601
(502) 564-3590

Division of Energy

(Natural Resources & Environmental Protection Cabinet)
663 Teton Trail
Frankfort, KY 40601
(502) 564-7192

Division of Facilities Management

(Education, Arts and Humanities Cabinet)
15th Floor Capital Plaza Tower
500 Mero Street
Frankfort, KY 40601
(502) 564-4326

Department for Local Government

1024 Capital Center Drive, Suite 340
Frankfort, KY 40601
(502) 573-2382

Universities That Manage State-Owned Buildings

Eastern Kentucky University

521 Lancaster Avenue
Richmond, KY 40475-3101
(606) 622-2101

Kentucky State University

400 East Main Street
Frankfort, KY 40601
(502) 227-6290

Morehead State University

201 Howell McDowell Administration Bldg.
Morehead, KY 40351-1689
(606) 783-2022

Murray State University

P O Box 9
Murray, KY 42071
(502) 762-3763

Northern Kentucky University

Nunn Drive
Highland Heights, KY 41099
(606) 572-5123

University of Kentucky

104 Administration Building
Lexington, KY 40506-0032
(606) 257-1701

University of Louisville

2301 South 3rd Street
Louisville, KY 40208
(502) 852-5420

Western Kentucky University

1 Big Red Way
Bowling Green, KY 42101
(502) 745-4346

State Agencies That Manage State-Owned Buildings

Economic Development Cabinet

Capital Plaza Tower
500 Mero Street
Frankfort, KY 40601
(502) 564-7670

Cabinet For Families and Children

275 East Main
Frankfort, KY 40601
(502) 564-7130

Finance and Administration Cabinet

Room 383, Capitol Annex
Frankfort, KY 40601
(502) 564-4240

Cabinet For Health Services

275 East Main Street
Frankfort, KY 40601
(502) 564-7130

Justice Cabinet

Bush Building, Second Floor
403 Wapping Street
Frankfort, KY 40601
(502) 564-7554

Labor Cabinet

1047 US 127 South, Suite 4
Frankfort, KY 40601
(502) 564-3070

Natural Resources & Environmental Protection Cabinet

Capital Plaza Tower
Frankfort, KY 40601
(502) 564-3350

Public Protection and Regulation Cabinet

90 Airport Road
Frankfort, KY 40601
(502) 564-7760

Tourism Development Cabinet

Capital Plaza Tower, 24th Floor
500 Mero Street
Frankfort, KY 40601
(502) 564-4270

Transportation Cabinet

State Office Building
Frankfort, KY 40601
(502) 564-4890

Workforce Development Cabinet

Capital Plaza Tower
500 Mero Street
Frankfort, KY 40601
(502) 564-6606

Administrative Office of the Courts

100 Millcreek Park
Frankfort, KY 40601
(502) 573-2350

Military Affairs

Office of Management and Administration
Boone National Guard Center
100 Minuteman Parkway
Frankfort, KY 40601-6168
(502) 564-8529

Please contact the Kentucky Division of Energy at
(502) 564-7192 or (800) 282-0868 for a list of
qualified Energy Service Companies operating in
Kentucky.



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